

**Statement of Jeff Dirksen**  
**Director of Congressional Analysis, National Taxpayers Union & Foundation**  
**before the**  
**United States Senate**  
**Committee on Commerce, Science, and Transportation**  
**on**  
**Internet Taxation**  
**March 14, 2001**

Mr. Chairman, Senator Hollings, Members of the Committee, I appreciate the opportunity to testify today on such a critical technological and economic issue facing America. I am the Director of Congressional Analysis for National Taxpayers Union Foundation, the education and research arm of the National Taxpayers Union (NTU). NTU is America's oldest and largest grassroots taxpayer organization with over 300,000 members in all 50 states. I am here on behalf of NTU and its membership to urge you to extend the Internet Tax Moratorium and to ensure that the Internet and online transactions remain tax-free.

Today, I want to share three taxpayer concerns about increasing taxes on Internet usage and applying additional tax structures to Internet transactions. First, taxpayers are already burdened with heavy taxes, fees, and other charges on telecommunications services, and adding more is moving in a counterproductive direction. Second, concerns that essential government services will disappear, because certain online transactions are not taxable, are false. Actually, state tax revenues are growing at a near record pace. Third, the imposition of taxes on Internet sales will make life for taxpayers and retailers far too complicated.

**1.) There are enough taxes, fees, and other charges on telecommunications services and adding more is heading in a counterproductive direction.**

Cutting taxes, especially those levied on telecommunications and e-commerce activities, is beneficial to consumers. Both the public and private sectors have benefited significantly from the deregulation of the telecommunications industry and from the productivity gains made possible by telecom products and the Internet. Yet, the National Conference of State Legislatures reported last February that nearly 11,000 state and local governments levy taxes or fees on telecommunication activities, including franchise taxes, utility taxes, line access and right-of-way charges, 911 fees, relay charges, and maintenance surcharges.<sup>1</sup> A Federal

Communications Commission survey of 95 metropolitan areas determined that the average tax rate levied by all governments on a phone bill was 15.7 percent. In Richmond, Virginia, the highest-taxing jurisdiction in the analysis, the rate approached 36 percent.

In early trading this past Monday, the Nasdaq Composite Index was down 2.9 percent, sinking below the 2,000-point level for the first time since December 16, 1998.<sup>2</sup> In the last twelve months, the Nasdaq has fallen nearly 60 percent. The last thing that a slumping technology sector needs is higher taxes on the industry and its consumers. In the interest of full disclosure, I must admit that I now have a personal stake in this issue. I learned late Sunday night that my brother-in-law who farms near Gann Valley, South Dakota, has decided to leave farming and will begin working for an ISP – which is probably not listed on the Nasdaq – in nearby Woonsocket, where my sister has been working for a mail order firm that sells duck decoys. The Internet touches the lives of people from all across the globe, including those on the Great Plains. Extending the Internet Moratorium will help technology firms, both large and small, including one in Woonsocket, South Dakota.

Rather than placing hurdles in front of the telecommunications and e-commerce industries, Congress should instead consider reducing or eliminating tax barriers. Last year's attempt to repeal the 103-year old telephone excise tax was a step in the right direction. NTU endorsed the Portman-Matsui bill, H.R. 3916, which the House passed 420 to 2 on May 25, 2000. Congress should move beyond the simple repeal of the 3 percent phone excise tax, and make the current moratorium on Internet taxes permanent, as well as establish the Internet as a tax-free zone for the sale of goods and services in perpetuity.

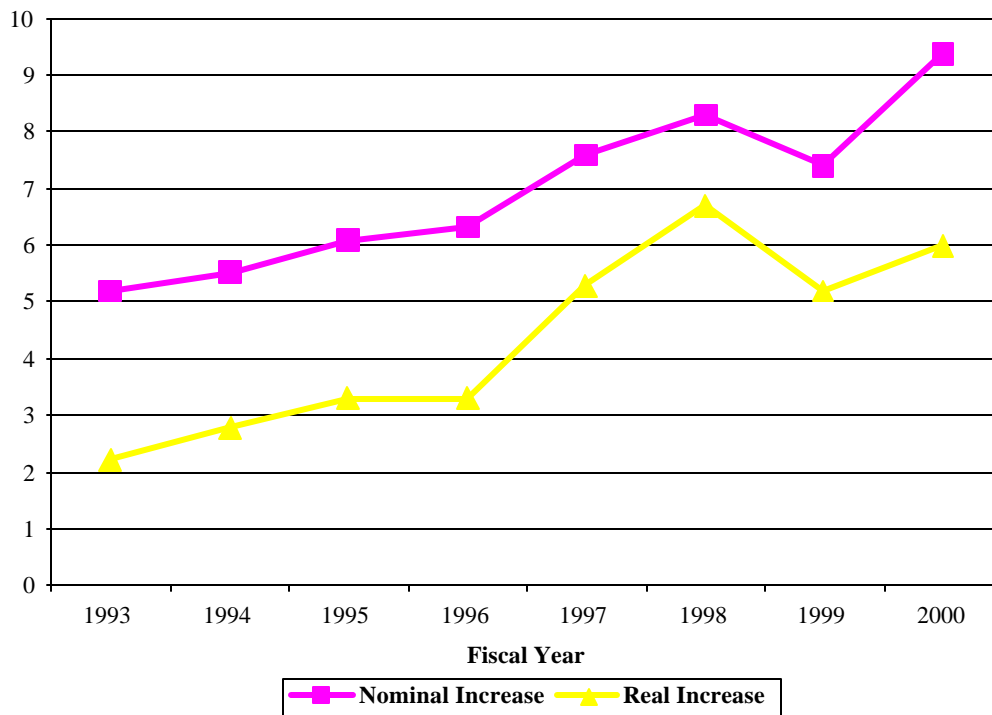
Moving in the wrong direction will have significant consequences. In 1998, economist Austan Goolsbee found that the number of online shoppers would fall by 25 percent, and the amount of dollars spent would plunge by 30 percent, if existing sales taxes were applied to Internet purchases.<sup>3</sup> Last year, a poll of 1,016 America Online subscribers found that two-thirds said "they'd be a lot or a little less likely to shop online if their purchases were subject to a uniform sales tax."<sup>4</sup> The Internet is a shopper's dream. In addition to offering just about every product imaginable, it allows consumers to compare prices, products, and providers quickly and easily with little out-of-pocket expense. Consumers no longer need to spend time driving from mall to mall looking for the best possible deal since the deals literally come to them – a definite benefit to those who may be homebound or may have difficulty traveling to shopping centers. Haggling is virtually eliminated because a better price is just a click away. Shackling the Internet with additional taxes will push many consumers offline, and for those who are able, back into their cars.

Any scheme that intends to simplify, streamline, or to make sales taxes "fairer" online is just one step away from trampling the Supreme Court's 1992 *Quill* ruling. Consumers should be wary of this backdoor attempt to run roughshod over the Court's restrictions on taxing phone and catalog sales. If such a system of extraterritorial collection is allowed, Congress will have opened the door to any number of potential tax cartels that will eventually harm rather than help taxpayers.

## 2.) The argument that state revenue coffers will be devastated is bogus.

Despite assertions to the contrary, taxpayers are already chipping in more than their fair share, and state government coffers are flush with cash. According to The Nelson A. Rockefeller Institute of Government, state tax revenues grew 8.7 percent in Fiscal Year 2000. This represents the second largest year-over-year increase in the last decade, after adjusting for inflation.<sup>5</sup> Even when adjusting for the impact of legislated tax cuts, states have continued to see strong year-over-year revenue growth for the last eight fiscal years (See Figure 1).

**Figure 1. Annual Nominal & Real Increases in State Tax Revenues, Adjusted for Tax Cuts**



*Source: The Nelson A. Rockefeller Institute of Government.*

Those who support broadening the ability of states to collect sales taxes on remote retailers suggest that the potential rise in e-commerce will deprive states of billions of dollars in needed revenue and that essential government services will suddenly disappear.<sup>6</sup> This scare tactic serves the interests of those who wish to raise taxes and expand government, yet the Department of Commerce reports that retail e-commerce sales in calendar year 2000 totaled \$25.8 billion, or just 0.8 percent of all retail sales.<sup>7</sup> While states believe the information super-highway to be paved with gold, it is important to remember that many online transactions, such as business-to-business sales and online services, would not be taxable in most states, resulting in far lower revenue gains than expected. In its report from last year, the General Accounting Office noted, "Little empirical data exist on the key factors needed to calculate the amount of sales and use tax revenues that state and local governments lose on Internet and other remote sales. What information does exist is often of unknown accuracy."<sup>8</sup> As Senator Wyden correctly observed

when introducing the Internet Tax Nondiscrimination Act, “Not a single community has come forward and proved that it is being injured by its inability to impose discriminatory taxes on electronic commerce. There is no evidence that the states have lost revenue by technology-driven economic activity.”<sup>9</sup>

**3.) Attempts to simplify and harmonize sales tax codes will make life far too complicated for taxpayers and retailers.**

Any tax simplification scheme will require an extremely large table to ensure that everyone who has an interest in the discussion has a seat. If an agreement among the 46 states that impose a sales tax was all that was needed, the process might only be somewhat painful. However, there are an estimated 7,458 entities, including cities, counties, and other jurisdictions, that impose a sales tax (See Figure 2). Obtaining agreement among all jurisdictions would seem virtually impossible.

<b>Figure 2. Number of Government Entities Imposing Sales &amp; Use Taxes</b>	
Type of Jurisdiction	Number
States	46
Cities	4,696
Counties	1,602
Other Jurisdictions	1,113
Total	7,458
<i>Source: Ernst &amp; Young LLP.</i>	

The ensuing debate among these entities will make past attempts by the European Union to set standards for what constitutes “marmalade,” “mayonnaise,” or a “cucumber” seem like a pleasant tea party in comparison. Variances in statutory definitions will force states to develop a new common definition for all goods available on the Internet, leading to questions about whether chocolate candies are a food and should be taxed as such. Ironically, a press release from the National Governors Association (NGA) expresses their support for a simplified sales tax structure by highlighting the difficulties associated with taxing a marshmallow. NGA argues that the definitional differences across various states make it “very difficult for retailers to calculate, collect, and remit taxes on transactions that are done in multiple locations.”<sup>10</sup> Actually, there is a very simple way to avoid this problem: do not let states trample on *Quill*. One hesitates to ponder the amount of time and taxpayer money that will be consumed by endless wrangling over definitions for candies and marshmallows.

Again, taxpayers should be wary of attempts to harmonize or simplify tax structures across state boundaries. Once tax officials have “simplified” the system for Internet sales, then the next step is to impose the structure on mail order sales, and then extend it to all retail purchases. This last step is the ultimate goal of NGA’s simplification proposal. It is conceivable that under this simplified tax scheme, Equal Protection and Commerce Clause concerns will arise, and local merchants will be required to collect and remit out-of-state sales taxes when selling goods across

the counter to customers from another state.<sup>11</sup> Creating more paperwork and headaches for all business owners is not our idea of making something simple.

Additionally, one must ask whether it is wise to end tax competition among states. The current sales tax structure allows states and localities to determine taxing priorities, allowing tax bases and rates to vary as legislative bodies see fit. Before joining NTUF, I worked as a Revenue Analyst for the Commonwealth of Pennsylvania's Department of Revenue, which like many states, has chosen to exempt certain activities or industries from sales and use taxes. For example, "Tangible personal property used directly in the production of a feature-length commercial motion picture distributed to a national audience is exempt from taxation."<sup>12</sup> Why does the Commonwealth provide this exemption? It wants to encourage commercial films to be made in Pennsylvania. Via another exclusion, the Commonwealth exempts foundations for machinery and equipment in an attempt to prevent multiple taxation "which could occur in the production of a finished good for consumption."<sup>13</sup> The Commonwealth also provides sales tax exemptions for bakers and horse breeders, in addition to numerous others. NTU frequently receives letters and email messages from individuals who are considering relocating and want to find information on state and local tax burdens. These individuals see tax competition among states as extremely beneficial. Adopting a scheme to harmonize and simplify sales taxes structures would kill a state's competitive tax advantage, trample that state's sovereignty, remove incentives to keep taxes low, and hurt taxpayers in the process.

Even if a consensus agreement on what constitutes a marshmallow and how it should be treated under a simplified system does emerge, new software to track, collect, and remit revenues will be required. Should anyone believe that this process would be simple or smooth, I would point out the difficulties in revamping the Internal Revenue Service (IRS). By our count, the IRS has reorganized itself 29 times since 1952.<sup>14</sup> According to the Service's 1984 annual report, "Within the next five to ten years we will have a totally redesigned tax administration system. Paper tax returns can largely be a thing of the past."<sup>15</sup> Yet, in 1996, the IRS announced that after having spent more than \$4 billion to modernize its computer systems that its efforts were "badly off track."<sup>16</sup> During my time as a Department of Revenue employee, the Department contracted with a private consulting firm to develop a Pennsylvania sales and use tax model to aid in forecasting tax collections. After nearly two years of development and testing the model, the Department was still not satisfied that the package could accurately model sales transactions in the Commonwealth. Writing software to address the collection and remittance needs of 7,500 governmental entities will be a programmer's nightmare and a potential taxpayer-funded boondoggle.

Add the uncertain economic impact that blanket Internet taxes could have on this dynamic sector, and the message to Congress could not be more clear: Congress should declare this tax territory "off limits" by extending the Internet Tax Moratorium and preventing states from imposing sales taxes on online transactions.

## Endnotes

---

<sup>1</sup> Scott Mackey, "Telecommunications and the Tangle of Taxes," *State Legislatures*, February 2000, <http://www.ncsl.org/programs/pubs/200TELE.HTM>.

<sup>2</sup> David Runk, "Nasdaq Drops 2.9% as Outlook Worries Drag Down Market," *The Wall Street Journal*, WSJ.com, March 12, 2001.

<sup>3</sup> Austan Goolsbee, "In a World Without Borders: The Impact of Taxes on Internet Commerce," National Bureau of Economic Research, *Working Paper No. W6863*, December 1998.

<sup>4</sup> David Muhlbaum, "AOL Members Say No New Net Taxes," CBS MarketWatch, March 20, 2000, [http://netscape.marketwatch.com/source/blq/netscape/archive/20000320/news/current/cbsmwaol\\_poll.nsp](http://netscape.marketwatch.com/source/blq/netscape/archive/20000320/news/current/cbsmwaol_poll.nsp).

<sup>5</sup> Nicholas W. Jenny and Elizabeth I. Davis, "Fiscal 2000 Tax Revenue Growth: Strongest of the Last Decade," *State Fiscal Brief*, No. 61, The Nelson A. Rockefeller Institute of Government, February 2001.

<sup>6</sup> Andrew Caffrey, "States at Odds Over Web Taxes," *The Wall Street Journal*, March 7, 2001, p. B3.

<sup>7</sup> United States Department of Commerce, "Retail E-commerce Sales in Fourth Quarter 2000 Were \$8.7 Billion, Up 67.1 Percent from Fourth Quarter 1999, Census Bureau Reports," Press Release, February 16, 2001, <http://www.census.gov/mrts/www/current.html>.

<sup>8</sup> United States General Accounting Office, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, June 2000, p. 3.

<sup>9</sup> John Connor, "'Internet Tax Freedom' Bill Proposed in US House, Senate," Dow Jones Newswires, February 8, 2001.

<sup>10</sup> National Governors Association, "Streamlined Sales Tax Project Gains Momentum," Press Release, March 8, 2001, [http://www.nga.org/nga/newsRoom/1,1169,C\\_PRESS\\_RELEASE^D\\_1453,00.html](http://www.nga.org/nga/newsRoom/1,1169,C_PRESS_RELEASE^D_1453,00.html)

<sup>11</sup> Adam D. Thierer, "The NGA's Misguided Plan to Tax the Internet and Create a New National Sales Tax," *The Heritage Foundation Backgrounder No. 1343*, February 4, 2000.

<sup>12</sup> *Governor's Executive Budget 2001-2002*, Commonwealth of Pennsylvania, p. D42.

<sup>13</sup> *Ibid.*

<sup>14</sup> Peter J. Sepp, "NTU Official Serves on IRS Reform Panel," *Dollars & Sense*, August 7, 1996, p. 4.

<sup>15</sup> Cited in Shelley L. Davis, *Unbridled Power* (HarperBusiness) 1997, p. 48.

<sup>16</sup> *Ibid.*